Internal Revenue Service Department of the Treasury Washington, DC 20224 Number: 201310020 Release Date: 3/8/2013 Index Number: 856.00-00 Person To Contact: , ID No. Telephone Number: Refer Reply To: CC:FIP:B01 PLR-131958-12 Date: December 05, 2012 Taxpayer Property = Department = Α = В С = D = Ε = F G = Н = Year 1 = Dear

This is in response to your letter dated July 12, 2012 requesting rulings on behalf of Taxpayer. You have requested rulings that (i) the boat slips at the Property constitute

real estate assets within the meaning of section 856(c)(4) of the Internal Revenue Code of 1986, as amended (the "Code"), (ii) Taxpayer's rental income from the boat slips at the Property constitutes "rents from real property" within the meaning of sections 856(c)(2) and (3) and (iii) the employment of the dock master at the Property will not cause otherwise qualifying income to be excluded from the definition of "rents from real property" under sections 856(c)(2) and (3).

FACTS

Taxpayer intends to acquire a leasehold interest in the Property. The lessor of the Property is Department and the term of the lease is A years with a possibility of extension until Year 1. Taxpayer will hold its interest in the Property through one or more partnerships or LLCs, each of which will be treated as a partnership or disregarded entity for federal income tax purposes.

The Property is comprised of residential rental property units (the "Apartments"), as well as, a marina containing boat slips and end ties (the "Marina"). After substantial renovation, the Property will consist of B Apartments, C boat slips and D end ties. The boat slips will range in size from E feet up to F feet and are accessed by means of large floating docks. The floating docks will be held in place by fixed pilings that are attached to the harbor floor. In addition to replacing the existing boat slips and gangways, the Marina renovations will also include new boat slip security gates, locker storage boxes and cleats and a new electrical system, freshwater system, fire suppression system and sewage pumpout system.

The boat slips at the Marina will be leased independently of the Apartments (so that a tenant may lease only at the Apartments, only at the Marina, or both at the Marina and the Apartments). Marina tenants will lease the boat slips for a minimum of G, and are required to post a security deposit when they sign a lease. Approximately H percent of the Marina tenants are expected to be "live aboard" tenants who will reside on their boats, although the "live aboard" tenants will receive no special services or amenities. Marina tenants will have access to restrooms, showers, and lockers, but will not have access to the clubhouse or other common amenities provided to Apartment tenants. However, Marina tenants will be provided with a deck box adjacent to each boat slip for storage purposes. Marina tenants will tie their boats to the floating docks at the Marina, and all marina tenants will have access to the ocean from their boat slips. Marina tenants will have access to certain utilities: sewage, electricity, and water will be submetered by the utility company to each tenant's individual boat slip, and dumping services will be provided at the dock. All utilities will be separately metered to each Marina tenant. The Marina will employ a dock master, who will manage all aspects of the Marina, such as leasing, collecting rents, enforcing rules, serving late rent notices, filing unlawful detainer actions, advertising, maintaining income receipts, ensuring compliance with apartment rules, and managing tenant relationships.

Marina boat slips are leased to tenants as a lease of "premises," namely a lease of a "Slip", via standard lease agreements (the "Marina Lease Agreements"), for a minimum duration of G. The Marina Lease Agreements contain typical real estate lease terms, such as the lessee's provision of a security deposit, rental payments due on the first day of each month, lessor's right to enter the premises during an emergency, lessee's obligation to carry liability insurance, prohibitions on assignment, and a landlord's right to retake possession of each leased Slip by legal action after a payment default. Additionally, the Marina Lease Agreements state clearly that they are personal to the lessee (and non-assignable) and that if a lessee sells its interest in a boat housed at the Marina, "the new owner and/or possessor shall have no right to the Slip." Finally, Taxpayer represents that in accordance with section 856(d)(1), the portion of the boat slip rental income attributable to the floating docks and any other personal property at the Marina for the taxable year does not exceed 15 percent of the total rental income from the Marina Lease Agreements for the taxable year attributable to both the real and personal property leased in connection with such rental income. For this purpose, the rental income attributable to personal property for the taxable year is that amount which bears the same ratio to the total rental income for the taxable year as the average of the fair market values of the personal property at the beginning and at the end of the taxable year bears to the average of the aggregate fair market values of both the real and the personal property at the beginning and at the end of such taxable year.

LAW AND ANALYSIS

Issue 1

Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash, and cash items (including receivables), and Government securities.

Section 856(c)(5)(B) provides that the term "real estate assets," for purposes of section 856, means real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs that meet the requirements of sections 856 through 859.

Section 856(c)(5)(C) provides that the term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire leaseholds of land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil, or gas royalty interests.

Section 1.856-3(b) of the Income Tax Regulations (the "Regulations") provides, in part, that the term "real estate assets" means real property. Section 1.856-3(d) provides that "real property" includes land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural

components of such buildings or structures). In addition, the term "real property" includes interests in real property. Local law definitions will not be controlling for purposes of determining the meaning of "real property" for purposes of section 856 and the Regulations thereunder. Under the Regulations, "real property" includes, for example, the wiring in a building, plumbing systems, central heating or central airconditioning machinery, pipes or ducts, elevators or escalators installed in a building, or other items which are structural components of a building or other permanent structure. The term does not include assets accessory to the operation of a business, such as machinery, printing press, transportation equipment which is not a structural component of the building, office equipment, refrigerators, individual air-conditioning units, grocery counters, furnishings of a motel, hotel, or office building, etc. even though such items may be termed fixtures under local law.

Section 1.856-3(g) provides that a REIT that is a partner in a partnership is deemed (1) to own its proportionate share of each of the assets of the partnership and (2) to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the partner's interest in the partnership's assets is determined in accordance with the partner's capital interest in the partnership.

Rev. Rul. 71-286, 1971-2 C.B. 263, considers whether air rights over real property are considered "interests in real property" and "real estate assets" within the meaning of section 856(c). The term "air rights" is defined as the long-term leasehold or fee simple ownership of the space above the ground that a landowner can occupy or use in connection with the land, plus necessary easements on the surface for support of structures erected in such air space. The revenue ruling holds that such air rights are considered "interests in real property" and "real estate assets" within the meaning of section 856(c).

The right to use a geographically fixed plot of water (and the seabed underneath it) is directly analogous to air rights. The value of the air rights derives from the ability to build new construction for future occupancy or use in a given space (or to restrict others from building in this space). Water rights, by contrast, convey the present right to occupy or use a space. Here, Taxpayer's Marina Lease Agreements convey rights to a slip. A "slip" in the nautical sense is defined by Merriam-Webster as "a ship's or boat's berth between two piers," thus referring to the water space in which a ship or boat is berthed. In the case of both air rights and water rights, there is a real property interest in the space immediately above solid ground: air rights govern the space above land, while water rights govern the space above the seabed. In the present case, Taxpayer will acquire an interest in a long-term ground lease with Department to occupy the Marina and Apartments. Like the rights to use and occupy the space above land constitute a real property interest for purposes of section 856(c), the rights to use and occupy the space above the seabed equally constitute a real property interest under section 856(c).

Issues 2 and 3

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, rents from real property.

Section 856(d)(1) provides that rents from real property include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property; (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated; and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to the personal property for the taxable year does not exceed 15 percent of the total rent for the tax year attributable to both the real and personal property leased under, or in connection with, the lease.

Section 1.856-4(b)(1) provides that, for purposes of sections 856(c)(2) and (c)(3), the term "rents from real property" includes charges for services customarily furnished or rendered in connection with the rental of real property, whether or not the charges are separately stated. Services rendered to tenants of a particular building will be considered customary if, in the geographic market in which the building is located, tenants in buildings of a similar class are customarily provided with the service. In particular geographic areas where it is customary to furnish electricity or other utilities to tenants in buildings of a particular class, the submetering of those utilities to tenants in the buildings will be considered a customary service.

Section 1.856-4(b)(5)(ii) of the regulations provides that the trustees or directors of a REIT are not required to delegate or contract out their fiduciary duty to manage the trust itself, as distinguished from rendering or furnishing services to the tenants of its property or managing or operating the property. Thus, the trustees or directors may do all those things necessary, in their fiduciary capacities, to manage and conduct the affairs of the trust itself including establishing rental terms, choosing tenants, entering into renewal of leases, and dealing with taxes, interest, and insurance relating to the REIT's property. The trustees may also make capital expenditures with respect to the REIT's property (as defined in section 263).

Section 856(d)(2)(C) provides that any impermissible tenant service income is excluded from the definition of "rents from real property." Section 856(d)(7)(A) defines "impermissible tenant service income" to mean, with respect to any real or personal property, any amount received or accrued directly or indirectly by the REIT for services furnished or rendered by the REIT to tenants at the property, or for managing or operating the property.

Section 856(d)(7)(B) provides that if the amount of impermissible tenant service income exceeds one percent of all amounts received or accrued during the tax year directly or indirectly by the REIT with respect to the property, the impermissible tenant service income of the REIT will include all of the amounts received or accrued with respect to the property. Section 856(d)(7)(D) provides that the amounts treated as received by a REIT for any impermissible tenant service shall not be less than 150 percent of the direct cost of the REIT in furnishing or rendering the service.

Section 856(d)(7)(C) provides certain exclusions from impermissible tenant service income. Section 856(d)(7)(C) provides that for purposes of section 856(d)(7)(A), services furnished or rendered, or management or operation provided, through an independent contractor from whom the REIT does not derive or receive any income shall not be treated as furnished, rendered, or provided by the REIT, and there shall not be taken into account any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

Section 512(b)(3) provides, in part, that there shall be excluded from the computation of unrelated business taxable income all rents from real property and all rents from personal property leased with such real property, if the rents attributable to such personal property are an incidental amount of the total rents received or accrued under the lease, determined at the time the personal property is placed in service.

Section 1.512(b)-1(c)(5) provides that payments for the use or occupancy of rooms and other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, or apartment houses furnishing hotel services, or in tourist camps or tourist homes, motor courts or motels, or for the use or occupancy of space in parking lots, warehouses, or storage garages, do not constitute rent from real property. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The supplying of maid service, for example, constitutes such service; whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, and the collection of trash are not considered as services rendered to the occupant.

Taxpayer represents the services described above are usual or customary services that are rendered in connection with the operation or maintenance of the Property and are not rendered primarily for the convenience of tenants. The limited activities in which Taxpayer is involved are not services rendered for the convenience of tenants under section 1.512(b)-1(c)(5). Trustees or directors of Taxpayer also may perform fiduciary functions as provided in section 1.856-4(b)(5)(ii). Accordingly, based on the information submitted and representations made the services furnished by Taxpayer through its dock master in connection with the leasing of the Marina will not

cause any amounts received from tenants of the Marina to be treated as other than "rents from real property" under section 856(d).

CONCLUSION

Based on the information submitted and the representations made, we conclude that (i) the boat slips at the Property constitute real estate assets within the meaning of section 856(c)(4) of the Code, (ii) Taxpayer's rental income from the boat slips at the Property constitutes "rents from real property" within the meaning of sections 856(c)(2) and (3) and (iii) the employment of the dock master at the Property will not cause otherwise qualifying income to be excluded from the definition of "rents from real property" under sections 856(c)(2) and (3).

Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences relating to the facts herein under any other provision of the Code. Specifically, we do not rule whether Taxpayer otherwise qualifies as a REIT under part II of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Taxpayer should attach a copy of this ruling to each tax return to which it applies. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,
<u>Diana Imholtz</u>
Diana Imholtz
Branch Chief, Branch 1
(Financial Institutions & Products)